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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000958

SIPDIS

DEPT FOR EB/ESC, EUR/CARC
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DEPT FOR S/EEE AMB MORNINGSTAR AND DSTEIN
DEPT FOR EB/ESC DAS DOUG HENGEL
DEPT FOR S/CT FOR GROBERTSON, DKURSCH, CLARKS
DOE FOR LEKIMOFF, MBURPOE, AND DGOTTFRIED

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TAGS: [ENRG](#) [EPET](#) [ECON](#) [PREL](#) [TU](#) [AJ](#)

SUBJECT: GAS TRANSIT NEGOTIATIONS DRAG IN WAKE OF ERDOGAN
VISIT

REF: A. BAKU 916

[1](#)B. BAKU 754

Classified By: Charge Don Lu
Reasons 1.4 (B,D, E)

Summary

[1](#)1. (C) All eyes in the Azerbaijani energy sector have been on Washington, where President Obama and Prime Minister Erdogan met this week. Azerbaijan and Turkey appear to have engaged in a last minute flurry of negotiations in the hopes of striking a deal before the visit. Success eluded them. SOCAR told us the parties had broadly reached an agreement on Shah Deniz I and II prices, but gas transit costs for the Interconnector Italy-Turkey-Greece (ITGI) remain contentious. How to apportion potential future increases in the price of fuel gas, which would be used to power the ITGI pipeline, appears to be the last remaining significant area of disagreement, albeit a large one. Nassirov was dismayed that Turkey appears to be taking an increasingly tough line, by talking up alternatives to transiting Azerbaijani gas - that is, transiting gas from Turkmenistan, Iraq, and Iran. BP was generally upbeat about the Obama-Erdogan discussions, Statoil a bit less so.

Transit Fee Remains a Sticking Point

[1](#)2. (C) In a 7 December phone conversation from Turkey, SOCAR Vice President Elshad Nassirov updated the Mission on SOCAR's negotiations with Turkish Energy Minister Yildiz and BOTAS. Nassirov told us the parties had broadly reached an agreement on Shah Deniz I and II gas prices, but gas transit costs for the Interconnector Italy-Turkey-Greece (ITGI) remain contentious. BOTAS did not send any technical personnel to the meeting who were prepared to discuss specific transit figures, or who were familiar with the commercial aspects of gas transit. Nassirov hopes BOTAS will follow through on a commitment for 11 December to schedule a meeting with appropriate BOTAS transit personnel. Nassirov

again reiterated that BOTAS refused to share the commercial basis for its transit calculations.

13. (C) The parties appeared to reach some agreement on a transit figure of \$45/thousand cubic meters/100 km figure for the ITGI project. This is a significant concession on SOCAR's part from the \$32 it had previously demanded. (Reftels) However, there remains significant disagreement on how future price increases for the fuel gas used to power the pipeline would be handled. At current prices, the fuel to transit the gas would account for approximately \$5 of the \$45 total fee. However, according to Nassirov, BOTAS insists the fuel gas charges be indexed fully for inflation and gas fuel pricing, while SOCAR believes that \$45 should be the total transit fee cap, as SOCAR has already made significant concessions on transit pricing.

Tougher Line Noted

14. (C) When asked if BOTAS appeared to be taking a harder or more conciliatory line in these discussions, Nassirov told us that the Turkish negotiators were taking a much tougher line, pointing to recent deals with Iran, Iraq, and Turkmenistan to bolster their negotiating position vis a vis Azerbaijan. Nassirov also hinted that someone may be leaking information regarding the Shah Deniz consortium's negotiating parameters to the Turkish Minister of Energy, but was not willing to discuss specifics on the phone. We expect to have further discussions with Nassirov on 14 December and obtain further details on this point and the negotiations more generally.

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BP View: Generally Optimistic,
Some Concerns

15. (C) BP Vice President Seymour Khalilov told Energy Officer that BP was quite pleased that the gas issue made it onto the Obama-Erdogan agenda. Generally, Khalilov summarized, "the deal on the table is work-able, the gaps are small enough to be bridgeable." He stated that BP head the parties had agreement on gas volumes and Shah Deniz I and II prices, but had minor disagreements on transit. Transit "needs more detail," Khalilov explained.

16. (C) Khalilov also cautioned that BP and the Shah Deniz consortium members had to be cautious about going public with their views about the state of the gas negotiations. He related that the GOAJ had criticized BP in the past for "undermining Azerbaijan's negotiating position," when they had noted that two parties were not far apart in the concluding a gas deal.

17. (C) Khalilov further cautioned that there may be other reasons for the Turkey and Azerbaijan not to move forward, "both have reasons for wanting to take their time," he stated, alluding to the ongoing Turkey-Armenia protocol issue. In that vein, he expressed concern about a public comment made by Prime Minister Erdogan that the companies (e.g., the Shah Deniz consortium, led by BP) were "another factor," implying the companies might hold up or delay the deal. Khalilov noted that comment may have been "out of context," or it might reflect an "understanding" which BP believes may exist between President Aliyev and Prime Minister Erdogan. Khalilov is concerned that if these leaders find it politically problematic to approve a gas deal before the Turkey-Armenia protocol issue is resolved, they could point to the companies as the cause, effectively "scapegoating" BP and its partners.

Statoil Weighs In: No Progress Yet;
Generally Comfortable with Gas Prices

¶8. (C) Statoil Lead Negotiator Bjorn-Helge Kvia told Energy Officer that, from Statoil's perspective, the progress they hoped for on an Azerbaijani-Turkish gas agreement had not yet occurred. Kvia indicated that the Shah Deniz consortium partners "were generally comfortable with the level of gas prices," under discussion between Azerbaijan and Turkey, but was not willing to discuss specific figures on either gas pricing or transit.

¶9. (C) Regarding the impact of Turkey-Armenia rapprochement on the transit negotiations, Kvia noted that Statoil no longer operates in Turkey, but maintains an outreach office in Istanbul. Therefore the firm's ability to understand and offer insights on the Turkish political landscape is somewhat limited. Kvia assessed that Turkey failing to move forward swiftly on the normalization process was likely to have a beneficial impact on the Turkey-Azerbaijan energy discussions. Kvia was surprised to see the Nabucco Pipeline feature so heavily in the Prime Minister Erdogan's announcement in Washington, since SOCAR and many of the firms in Baku tend to believe that ITGI is the more realistic option in the short term.

¶10. (C) Post will report septel on next week's discussions with SOCAR.
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